

Income Tax Preferences

House Finance Tax Preference Subcommittee

**Virginia Department of Taxation
August 23, 2004**

Virginia's Income Tax Preferences

- **Virginia's income tax structure allows for three basic types of tax preferences.**
 - **Credits**
 - **Subtractions**
 - **Deductions**

Income Tax Credits

- **Tax credits directly reduce tax liability, usually dollar-for-dollar.**
- **Credits are usually equal to a certain percentage of an expenditure incurred by a taxpayer.**
- **However, some credits are based on a fixed dollar amount.**
- **For example:**
 - **The Historic Rehabilitation Tax credit is equal to 25% of the eligible expenses incurred in rehabilitating a historic structure.**
 - **The Major Business Facilities Jobs Tax Credit is equal to \$1,000 per new position created.**

Subtractions vs. Deductions

- **For individual and corporate income tax purposes, Virginia uses a “federal income” amount as its starting point for determining Virginia taxable income.**
- **Mathematically, deductions are identical to subtractions as both reduce Virginia taxable income.**
 - **The difference lies in the nature of the amount being subtracted/deducted.**

Income Tax Subtractions

- **Subtractions are generally used to prevent an item of income from being included in Virginia taxable income.**
 - **For individual income tax purposes, subtractions are only allowed to the extent they are included in “federal income.”**

Income Tax Subtractions (cont.)

- **With each subtraction, Virginia deconforms its computation of taxable income from the federal computation.**
 - **For example, the federal government chooses to partially tax social security income, whereas Virginia has chosen not to tax any social security income through the adoption of the subtraction of any social security income that was taxed for federal purposes.**

Income Tax Deductions

- **Deductions are generally used to reduce taxable income by an expense incurred by the taxpayer.**
 - **For example, primary and secondary school teachers are allowed to deduct 20% of their tuition expenses for continuing education requirements.**

Income Tax Computation

$$\begin{aligned} & \text{Federal Income} \\ & \quad + \text{Additions} \\ & \quad - \text{Subtractions} \\ & \quad - \text{Deductions} \\ & \quad - \text{Exemptions} \\ & = \text{Virginia Taxable Income} \\ & \quad \times \text{Tax Rate} \\ & = \text{Virginia Income Tax} \\ & \quad - \text{Tax Credits} \\ & = \text{Virginia Income Tax Due} \end{aligned}$$